IN THE HIGH COURT OF PUNJAB AND HARYANA AT CHANDIGARH

I.T.A. No. 98 of 2007

Date of Decision: 20.8.2007

M/s Monte International through Mr. Kulbhushan Goyal

....Appellant.

Versus

Commissioner of Income-tax, Rishi Nagar, Ludhiana

...Respondent.

CORAM:- HON'BLE MR. JUSTICE M.M. KUMAR.

HON'BLE MR. JUSTICE AJAY KUMAR MITTAL.

PRESENT: Mr. S.K.Mukhi, Advocate for the appellant.

AJAY KUMAR MITTAL, J.

This appeal is filed by the assessee under Section 260A of the Income Tax Act, 1961 (for short "the Act") against the order of the Income Tax Appellate Tribunal, Chandigarh Bench "B", Chandigarh (hereinafter referred to as "the Tribunal") passed in ITA No. 1231/Chandi/2005 on 31.7.2006 for the assessment year 2001-02. According to the learned counsel for the assessee, the following substantial questions of law arise for consideration of this Court:-

"1. Whether, on the facts and circumstances of the case, the ITAT was justified in confirming the action of CIT (A) in not allowing legal deduction as claimed by the appellant u/s 80HHC of the Income Tax Act,

1961 by completely ignoring the established principles of law regarding deeming provisions which provide for applicability of all the enabling provisions once an income is held to be business income either on the basis of its accrual, arising on receipt and/or under deeming provisions?

2. Whether, on the facts and circumstances of the case, the ITAT was justified in confirming the action of CIT (A) in not allowing legal deduction as claimed by the appellant u/s 80 HHC of the Income Tax Act, 1961 by completely ignoring the established principles of law regarding deeming provisions though applying the provisions of section 41 (1)(a) of the Income Tax Act, 1961 while on the other hand completely ignoring the true nature of the impugned amount of cessation of liabilities which had resulted in the reduction of purchase price of the raw material and thereby resulting into more Export Profits and thus cannot be denied the impugned deduction u/s 80 HHC of the Income Tax Act, 1961?

3. Whether, on the facts and circumstances of the case, the findings of ITAT are perverse and against the evidence on record and, thus, unsustainable in law?"

Briefly noticed the facts are that the assessee is a partnership firm dealing in Export of thread bar and it filed its income tax

return for the assessment year 2001-02 on 30.10.2001 declaring its income as Rs.5,28,855/-. The assessee claimed deduction under Section 80 HHC of the Act amounting to Rs.19,65,168/-. The details of export sales as well as other incentives including Duty Draw Back are given as under:-

(i)	Total Turnover	Rs.1,45,91,215/-
(ii)	Export Sales	Rs.1,43,82,742/-
(iii)	Export Incentives	
	(a) DEPB Licence	Rs.40,78,885/-
	(b) Duty Draw Back	Rs. 8,42,516/-
	Total	Rs.49,21,401/-
(iv)	Profit on DEPB licence premium included in the amount of DEPB incentive of Rs.40,78,885/- = Rs.2,85,278/-.	

The Assessing Officer declined to include an amount of Rs.3,52,581/- arising out of “cessation of trading liability” and held that the assessee was not eligible for the benefit under Section 80 HHC of the Act on the said amount. The assessee took the matter in appeal before CIT (A) who vide order dated 23.9.2004 affirmed the action of the Assessing Officer. He did not allow the claim of the assessee for deduction under Section 80 HHC of the Act with respect to the addition of Rs.3,52,581/-. Feeling aggrieved by the orders passed by the Assessing Officer and the CIT (A), the assessee filed an appeal before the Tribunal and the Tribunal vide its order dated 31.7.2007 partly allowed the appeal. Against the orders passed by the authorities below, the assessee has now approached this Court by way of present appeal.

The point that arises for consideration of this Court in the present appeal is whether income which is chargeable to tax under Section 41 (1) of the Act on cessation of liabilities of trade creditors is to be excluded or not from profits of business while calculating the deduction under Section 80 HHC of the Act.

Section 41 (1) of the Act deals with profits which are chargeable to tax arising on remission or cessation of trading liabilities. Under the provisions of sub-section (1) of Section 41 of the Act, an assessee who had been allowed any deduction on account of any loss, expenditure or trading liability in any year which ceases to be effective and as a result the assessee receives any amount in respect thereof, the amount so obtained by him or the value of benefit accruing to him is exigible to tax as income of the year in which such remission or cessation has taken place. By introducing fiction, the said receipt is chargeable under the head “income from business or profession.”

Now adverting to the provisions of Section 80 HHC of the Act, it may be noticed that according to the aforesaid provision deduction is to be allowed from the profits derived by an assessee from the exports of goods or merchandise while computing the gross total income and the object of this section is to grant an incentive to earners of foreign exchange and the matter has to be considered with reference to that object. Under sub-section (3) of Section 80 HHC, the mechanism for determination of profits derived from export of goods or merchandise has been prescribed for the purposes of sub-section (1). Clause (a) thereof deals with an assessee where the business is of export of goods or merchandise manufactured by the assessee. Clause

(b) relates to an assessee whose business is of export outside India of trading goods whereas Clause (c) applies to an assessee whose business comprised both export of manufactured goods and also of the trading goods. The computation referred to above is to be made having regard to the "profits of the business" which are to be determined in terms of clause (baa) of the Explanation to Section 80 HHC of the Act. The said Explanation provides that the expression "profits of the business" means the profits as computed under the head "profits and gains of business or profession" as reduced by 90% of the sums referred to in clauses (iiia), (iiib) and (iiic) of Section 28 or any receipts by way of brokerage, commission, interest, rent, charges and any other receipt of the similar nature included in such profits.

The question which emerges is whether the deeming fiction created by virtue of Section 41 (1) can be extended for the purpose of allowing deduction from "profits of the business" as referred to in Section 80 HHC of the Act. The effect of deeming fiction is limited to the purposes and scope for which it has been inserted. The Hon'ble Supreme Court in **Commissioner of Income-Tax, Kanpur v. Mother India Refrigeration Industries Pvt. Ltd., [1985] 155 ITR 711** while considering the scope of legal fiction observed that the legal fictions are created only for some definite purpose and that must be limited to that purpose and should not be extended beyond their legitimate field. The income chargeable to tax under Section 41 (1) of the Act is from reversal of any loss, expenditure or trading liability which had extinguished or ceased to exist. The legal fiction cannot be extended any further and the provisions of Section 80 HHC have to be

understood excluding the legal fiction created by deeming provisions contained in Section 41(1) of the Act as the source of income which is chargeable cannot be related to export of goods or merchandise. If any other meaning is assigned to the aforesaid fiction created with respect to Section 41 (1), it would be against the basic purpose and object of Section 80 HHC of the Act.

Further, in the present case during the course of assessment proceedings it was noticed that there were credit balance in the names of two parties amounting to Rs.3,52,581/- appearing in the books of account of the assessee. On being asked to verify the same, the assessee agreed to surrender it. The said cessation of liability could not be treated to have been earned from business of export and, thus, shall not form part of the turnover of the export business.

In view of the above, we do not find any merit in the appeal and accordingly, the substantial questions of law as claimed by the assessee are answered against it. The appeal is dismissed with no order as to costs.

(AJAY KUMAR MITTAL)
JUDGE

August 20, 2007 **(M.M. KUMAR)**
gbs **JUDGE**